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No. 93-627

In The

Supreme Court of the United States

October Term, 1993

ROBERT E. MEUNIER, EARL W. MILLER, and EDWARD GARIN,

Petitioners,

v.

MINNESOTA DEPARTMENT OF REVENUE, and DOROTHY A. McCLUNG, in her capacity as Minnesota Commissioner of Revenue,

Respondents.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Does 31 U.S.C. § 3124(a) (1988) exempt from state taxation some portion of the annuity payments received by a federal retiree from the Civil Service Retirement and Disability Fund ("the Fund") merely because the Fund invests in U.S. Government obligations and receives interest thereon?

Does state taxation of annuity payments from the Fund violate the doctrine of intergovernmental tax immunity where similar distributions from state and private pension funds are similarly taxed?

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The opinion of the Minnesota Supreme Court in this case is reported at 503 N.W.2d 125. That opinion and the unpublished opinion of the Minnesota District Court are reproduced in the Appendix to the Petition.

STATEMENT OF THE CASE

Respondents disagree with Petitioners' Statement of the Case because Petitioners have omitted the uncontroverted facts presented by Respondents' expert witnesses in addition to the stipulation.

Petitioners are three retired federal employees who each received annuity payments from the Civil Service Retirement and Disability Fund (hereinafter "Fund") in 1986. Each paid Minnesota income tax on the annuity payments he received. Subsequently, each filed a claim for refund of the Minnesota income tax paid, claiming that the annuity payments received were partially exempt from state taxation under 31 U.S.C. § 3124(a) (1988). The Minnesota Department of Revenue denied the claims and this refund action resulted.

The Fund was established by Congress in 1920. It is a separate account within the U.S. Treasury. *See* 5 U.S.C. §§ 8331(18) and 8348 (1988). Its functions are to receive contributions from federal employees, employing agencies, and the U.S. Treasury; receive income from investments; pay administrative expenses; and pay benefits,

primarily annuity payments, to retired and disabled federal employees and their survivors. Lodg. 8; App. C-4.[1]

The Fund is the account for two defined benefit retirement plans established for federal employees under federal law. These plans, the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), are administered by the Office of Personnel Management. 5 U.S.C. § 8347 (1988); Lodg. 2, 3, 8. Under these defined benefit plans, a retiree receives a certain defined stream of benefit payments which is determined by his length of service and salary level. Lodg. 10, 11, 31; App. C-5; S.App. 3. A retiree's benefit is not dependent upon the amount of his contribution or the income earned by the Fund. Lodg. 10, 11, 31; S.App. 3. The benefits paid arise from and are in consideration for the retiree's prior employment. S.App. 3-4, 6.

Additions to the Fund come from mandatory withholding from current federal employees, mandatory contributions from federal agencies, appropriations from the general fund of the U.S. Treasury, and investment income from United States Government securities (primarily nonmarketable securities with maturities fitting the Fund's needs and with interest rates based upon the average market yield of outstanding marketable securities) or from securities guaranteed by the United States; 5 U.S.C. § 8348(d) and (e) (1988); Lodg. 29, 37.

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[1] Petitioners' Appendix is abbreviated "App." and their Lodging "Lodg.". Respondents' Supplemental Appendix is abbreviated "S.App.".

The Fund is not designed as a "pass through" entity in which ownership and rights of ownership of the assets are passed to the participants. S.App. 3. It is not possible to determine the share of the Fund attributable to any retiree or unretired participant. S.App. 3, 7. There is no sense in which retirees or unretired participants in the plan are owners of U.S. Government securities or may be said to be receiving interest on U.S. Government securities. S.App. 3, 6.

For federal income tax purposes, the Fund is treated like a qualified pension plan trust under 26 U.S.C. § 401(a) (1988) that is exempt from income tax under 26 U.S.C. § 501(a) (1988). The payments received by a retiree are subject to federal income tax under 26 U.S.C. § 72 (1988). Under § 72, payments received by each retiree-Petitioner prior to the years in question were excluded from his federal gross income until each Petitioner had received an amount equal to his contributions to the Fund (on which he had already paid income tax). Thus each Petitioner recovered his "cost" or "basis" in his annuity. Thereafter all annuity payments received are taxed as ordinary income. App. C-5. Minnesota has adopted the foregoing income tax treatment as well. Minn. Stat. § 290.01, subd. 20 (1986).

The Minnesota tax on the annuity benefits of retirees is the same for all public and private pensions. Minn. Stat. § 290.01, subd. 20 (1986). The Minnesota tax is not dependent upon or computed with respect to the income, if any, received by the Fund. App. A-6 & 7. The imposition of Minnesota income taxes on annuity payments received from the Fund by retirees, disabled persons, and survivors does not increase the cost to the United States

of borrowing money nor does it diminish to any degree the market value or investment attractiveness of United States Government obligations. S.App. 2-3.

REASONS FOR DENYING THE PETITION

There is no reason for the Court to review this case. The Minnesota Supreme Court decided the matter correctly, following established legal principles. The decision below neither deviates from nor conflicts with governing statutes nor with judicial decisions. Moreover, the primary conflict claimed by Petitioners is with a one-paragraph decision of the Vermont Supreme Court affirming an unpublished lower court decision. Even if the Court were concerned that the issues presented might warrant further review, it would be prudent to allow additional courts the opportunity to analyze them. Then this Court's review, if necessary, would be fully informed by that additional scrutiny.

I. THE MINNESOTA SUPREME COURT'S DECISION DOES NOT CONFLICT WITH OTHER DECISIONS APPLYING 31 U.S.C. § 3124(a) (1988) BECAUSE THE MINNESOTA INCOME TAX DOES NOT REQUIRE THE INTEREST ON U.S. OBLIGATIONS TO BE CONSIDERED IN COMPUTING THE TAX.

The tax exemption for federal obligations is codified in 31 U.S.C. § 3124(a) (1988):

> Stocks and obligations of the United States are exempt from taxation by a State or political subdivision of a State. The exemption applies to

> each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except – (1) a nondiscriminatory franchise tax or other nonproperty tax instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax.

The statutory exemption has historically been treated as principally a restatement of the constitutional immunity for U.S. Government securities. *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983); *First National Bank of Atlanta v. Bartow County Bd.*, 470 U.S. 583 (1985). However, this Court has more recently made it clear that the statutory exemption is greater than that required by the Constitution. Absent the statute, states could constitutionally tax a holder of government bonds on bond interest, just as states can tax other private parties doing business with the United States, provided the tax does not discriminate against the United States or those with whom it deals. *South Carolina v. Baker*, 485 U.S. 505, 523, 526 (1988).[2]

As explained in the following sections, the Minnesota Supreme Court's decision in this case does not conflict with other decisions applying 31 U.S.C. § 3124(a) (1988). It does not conflict because the Minnesota income tax does not require the interest on U.S. obligations to be considered in computing the tax. The Minnesota decision is therefore consistent with *American Bank & Trust Co. v. Dallas County*, 463 U.S 855 (1983) and is distinguishable

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[2] The Petition at page 20 incorrectly states that the statutory exemption is constitutionally mandated.

from the state court decisions relied upon by Petitioners. In addition, the decision of the Vermont Supreme Court in *Keys v. Vermont Department of Taxes*, 552 A.2d 418 (Vt. 1987), *cert. denied*, 485 U.S. 1035 (1988) is distinguishable because that case did not involve state taxation of compensation paid for services by a defined benefit plan like the Fund, but rather involved state taxation of U.S. obligation interest earned on an investment in U.S. obligations. Decisions concerning regulated investment companies are distinguishable because the Civil Service Retirement and Disability Fund is not a conduit for investment in federal obligations as are regulated investment companies.

A. The Minnesota Supreme Court's Decision In This Case Does Not Conflict With This Court's Decision In *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), Because Interest On U.S. Obligations Is Not Taken Into Account In Computing The Minnesota Tax.

The decision of the Minnesota Supreme Court in this case does not conflict with this Court's application of 31 U.S.C. § 3124(a) (1988) in *American Bank*. *American Bank* considered the validity of a property tax imposed on bank shares. However, the tax was computed on the bank's net assets, which included the value of U.S. obligations held by the bank. *American Bank*, 463 U.S. at 856. The practical impact of the tax was indistinguishable from that of a tax imposed directly on the bank's assets, including the U.S. obligations. *Id.* at 862.

Prior to amendment of the exemption in 1959, a formalistic but economically meaningless distinction

between taxes on U.S. Government obligations and taxes on separate interests had permitted taxes to be computed on a bank's assets, including U.S. obligations, so long as the taxes were imposed on the bank shares and not directly on the U.S. obligations. *Id.* at 858. This formalism had been criticized as resting upon a distinction of words without substance. *Id.* at 866. This Court specifically recognized that the 1959 amendment to the exemption "rejected and set aside" that "rather formalistic pre-1959 approach to [the exemption]." *Id.* at 862.

In *American Bank* this Court examined the tax to determine whether U.S. obligations were "considered . . . in computing the tax." *Id.* To determine whether U.S. obligations were "considered" in computing the tax, the Court looked at whether the U.S. obligations were "taken into account or included in the accounting" in computing the tax. *Id.* The bank shares tax was computed on the bank's net capital assets, including the U.S. obligations. If the bank's assets increased, the tax increased, even though the additional assets were all U.S. obligations. This Court held that such a computation plainly took the U.S. obligations into account, at least indirectly, in violation of the exemption. *Id.* at 862-63.

The Minnesota Supreme Court applied the exemption just as this Court did in *American Bank*. Application of the *American Bank* test establishes that Minnesota's tax on the annuity payments received by retirees does *not* violate the exemption. The Minnesota tax is computed on the annuity payments received by the retiree without any consideration of the interest, if any, of the Fund. Because each retiree received a fixed annuity based only upon his years of service and the amount of his salary before

retirement (Lodg. 11; App. C-5) the amount of the annuity payments received is completely unaffected by any interest income that the Fund may, or may not, have. *See* S.App. 3. Thus, the annuity receipts and Minnesota's tax on them are wholly independent from and unaffected by the Fund's income. *See* App. A-6, A-7. Because Minnesota's income tax on retirees' annuity receipts is wholly independent from and unaffected by the Fund's income, or lack of income, the Fund's U.S. obligation income is not taken into account in computing the tax.

Accordingly the Minnesota Supreme Court found that "neither the amount of the annuity payments nor the amount of the Minnesota tax is measured by or computed on or dependent in any way on the amount of interest received by the Fund by reason of its ownership of U.S. securities." App. A-6. It concluded that "the tax is neither computed on nor measured by, either directly or indirectly, the amount of income realized by the Fund from U.S. securities."[3] App. A-7. This analysis and decision is

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[3] Reference to the "measure" of the tax recalls the Idaho tax which was the catalyst for the 1959 amendment to the exemption. Idaho imposed a tax "upon every individual . . . which shall be according to and measured by his net income" including income from U.S. obligations. Idaho's position was that its tax need not exempt interest received on federal obligations because the tax was imposed on the individual and was merely measured by his net income. *American Bank*, 463 U.S. at 865. "Congress intended [the 1959 amendment] to abolish the formalistic distinction between taxes *on* income and taxes *measured* by income that underlay Idaho's arguments." *First National Bank of Atlanta v. Bartow County Bd.*, 470 U.S. 583, 594 (1985). Contrary to the statement at page 19 of the Petition that the Minnesota Supreme Court decision is based upon the "formalistic distinc-

entirely consistent with this Court's analysis and decision in *American Bank*.

The complete separation of the tax from the Fund's U.S. obligation interest income is readily seen by hypothesizing changes in the Fund's U.S. interest income. If that income were twice as great, the annuities would nevertheless remain the same because they are based on years of service and highest salary. Minnesota's income tax on the retirees' annuity income would remain the same. Where, as in this case, there is no relationship at all between the amount of the tax and the U.S. obligation income, upholding the tax cannot in any way be said to conflict with this Court's decision in *American Bank*.

B. The Minnesota Supreme Court's Decision In This Case Does Not Conflict With The Vermont Supreme Court's Decision In *Keys v. Vermont Department Of Taxes*, 552 A.2d 418 (Vt. 1987), *cert. denied*, 485 U.S. 1035 (1988), Because *Keys* Did Not Involve A Tax On Compensation Paid Under A Defined Benefit Plan, But Rather Involved A Tax On U.S. Interest Paid In Addition To Compensation Under A Defined Contribution Plan.

The *Keys* decision is a one-paragraph order affirming the unpublished opinion of the Windsor County Vermont Superior Court in a dispute involving $1,449. App. D, E-2.

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tions" that have been invalidated by this Court, the Minnesota Supreme Court has made it clear that its decision is not so based.

Although *Keys* was decided in 1987, until it was distinguished by the Minnesota Supreme Court in this case, it had not been relied upon or even cited in a reported decision.

Unlike the detailed information that we have in this case, we know little about the Savings Incentive Plan of Bankers Trust New York Corporation which was involved in *Keys*. While the Windsor County Court decision refers to and had the benefit of a prospectus and a stipulation, Petitioners did not provide that information, even though they have urged that *Keys* should be followed and even though they had the burden of proof and persuasion.

Although we lack detailed information, *Keys* is distinguishable from this case. The first distinction between the cases is the nature of the payments that were received by the taxpayers. In this case, the payments which Petitioners received were deferred compensation for services previously rendered by Petitioners. In contrast, the payment that was in question in *Keys* was not compensation for services but was interest earned in addition to the compensation.

The retirement annuities that the Fund pays retirees and which are involved in this case are compensation for the retirees' past years of government service:

> We have no difficulty concluding that civil service retirement benefits [from the Civil Service Retirement and Disability Fund] are deferred compensation for past years of service rendered to the Government.

Davis v. Michigan Dep't of Treasury, 489 U.S. 803, 808 (1989); *accord Barker v. Kansas*, ___ U.S. ___, 112 S.Ct. 1619

(1992) (military retirement pay is deferred pay for past services). *See also* S.App. 3-4, 6.

Section 3124(a) does not exempt compensation paid to present or past federal employees from state income taxation. While compensation paid to federal employees was at one time held to be immune from state taxation, *New York ex rel. Rogers v. Graves*, 299 U.S. 401 (1937), that decision was specifically overruled two years later in *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939). The states' right to tax compensation paid to federal employees on a nondiscriminatory basis was immediately thereafter embodied in statute:[4]

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

4 U.S.C. § 111 (1988). The taxability of retirement benefits is further confirmed by *Davis*:

> [T]he overall meaning of 4 U.S.C. § 111 is unmistakable: *it waives whatever immunity* past and present federal employees would otherwise enjoy from state taxation of salaries, *retirement benefits, and other forms of compensation* paid on account of their employment with the Federal

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[4] Petitioners incorrectly state at page 25 of their Petition that "[p]rior to the adoption of 4 U.S.C. § 111, no state income taxation of federal employees was allowed."

> Government, except to the extent that such taxation discriminates on account of the source of the compensation.

489 U.S. at 810 (emphasis added).

Thus, this Court has expressly recognized that the payments in question in this case are payments to Petitioners of compensation for past services. Furthermore, Congress has expressly provided that the states may impose a non-discriminatory income tax on such compensation, as this Court acknowledged in *Davis*.

In contrast to this case, the payment in question in *Keys* was not compensation for past services. *Keys* involved interest "earned by" and paid to an individual taxpayer on his investment in the Savings Incentive Plan of Bankers Trust New York Corporation ("the Plan"), a defined contribution savings plan qualified under 26 U.S.C. § 401 (1988). App. D; E-1, 2. Pursuant to the taxpayer's direction, the compensation paid into the plan had been invested in U.S. obligations (App. D-2) and the amount in question was the interest earned on that investment (App. E-9). When the taxpayer received payment of a lump sum distribution from the Plan, the question was the taxability of that portion of the payment which was interest earned by the taxpayer on his investment. App. D-2. There was no question in *Keys* that the portion of the payment that represented compensation for his services was taxable. It is entirely payment of compensation for services that is subjected to tax in this case.

Thus, *Keys* is distinguishable because it involved the taxability of interest earned on the taxpayer's investment

in U.S. obligations while this case involves the taxation of compensation for past services.

The *Keys* decision is also distinguishable because, unlike this case, the Vermont tax was apparently computed on the amount of U.S. Government obligation interest which had been earned on the taxpayer's investment. The Vermont Court could thus conclude that under *American Bank* the tax violated § 3124(a) because the U.S. obligation interest was "taken into account or included in the accounting" in computing the tax. *American Bank*, 463 U.S. at 862. The Plan in *Keys* was a defined contribution plan (App. E-2) under which the taxpayer had a separate account and was entitled to receive the contributions to his account plus whatever was earned on those contributions. *See* App. E-9. An increase in the interest earned would have increased the amount paid to the taxpayer and the amount subject to tax. As previously discussed, there is no similar relationship between any income earned by the Fund and the Minnesota tax.

The *Keys* case is also distinguishable because in that case the U.S. obligation interest was separately credited to and became part of the individual taxpayer's separately owned account and was thus traceable to the taxpayer. The Minnesota Supreme Court noted this in its opinion. App. A-9. In contrast, in this case the U.S. obligation interest is not credited to any accounts and is not similarly traceable. The law provides simply that interest earned by the Fund becomes part of the Fund. 5 U.S.C. § 8348(c).

Unlike the taxpayer in *Keys*, Petitioners made and wanted the Minnesota courts to adopt numerous assumptions so they could compute an amount to claim as exempt. Petitioners did so even though none of their assumptions have any basis in fact. For example, Petitioners wanted the Minnesota courts to assume that the Fund's report for its fiscal year ending September 30, 1986, should be used to compute amounts for calendar 1986. There is no basis for such an assumption. Petitioners wanted the courts to assume that the interest earned by the Fund is not used to pay any of the Fund's administrative expense. This assumption is not only factually baseless, it is contrary to this Court's teaching in *First National Bank of Atlanta v. Bartow County Bd.*, 470 U.S. 583 (1985) that exempt U.S. obligations can be charged with their fair share of related expenses and burdens.

Petitioners wanted the Minnesota courts to assume that the Fund retained none of the interest earned, but paid out all interest in the year it was earned. Again, there is no basis for such an assumption. They also wanted the courts to assume that all payments made to beneficiaries throughout the year, even payments that were return of a beneficiary's basis, contained the same proportion of interest. This is yet another assumption for which there is no factual basis.

Petitioners' reliance on unfounded factual assumptions further shows the difference between this case and *Keys*.

For the foregoing reasons, the *Keys* decision is distinguishable and the decision of the Minnesota Supreme Court in this case does not conflict with it.

C. The Minnesota Supreme Court's Decision In This Case Does Not Conflict With Its Own Decision Or The Decisions Of Other State Courts Concerning The Tax Treatment Of Distributions From Regulated Investment Companies Because The Fund Is Not A Conduit For Investment In Federal Obligations.

The Minnesota Supreme Court, like other state courts which have addressed the issue, has held that dividends received from a regulated investment company (a mutual fund) are exempt from Minnesota income tax to the extent that the dividends are directly attributable to United States Treasury notes and bonds. *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990).[5] This case does not conflict with those decisions. Rather, those decisions serve to highlight the difference between the pension annuities which are the subject of this case and exempt U.S. interest.

The nature of regulated investment companies and their distributions to their shareholders are discussed in the cases from the various states and are well known. The securities and tax laws establish regulated investment companies as vehicles for investment in securities and currencies, and require such companies to so invest their shareholders' money. The laws also require regulated investment companies to annually report to each shareholder the result of his share of the investment and to distribute to each shareholder his share of the net income earned. Furthermore, within limits, the tax laws expressly

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[5] Cases from other jurisdictions are consistent with *Yurista* and are listed on page twenty of the Petition.

treat each shareholder-investor as though he directly earned a proportionate share of the income earned. 26 U.S.C. (Internal Revenue Code (I.R.C.)) §§ 851-855 (1988); *see Andras v. Illinois Department of Revenue*, 506 N.E.2d 439, 440 (Ill. App. Ct. 1987), *cert. denied*, 485 U.S. 960 (1988).

The particular characteristics given to regulated investment companies by the applicable statutes have led to their being described as "conduits" or "pass throughs" for investment income. The business of a regulated investment company is "to provide a conduit for investment" in securities. *Brown v. Franchise Tax Bd.*, 242 Cal. Rptr. 810, 813 (Cal. Ct. App. 1988). Securities owned as investments by a regulated investment company and the income from those securities have been recognized as being directly attributable to the shareholders because of the "conduit" or "pass through" characteristics statutorily given to regulated investment companies:

> The "earnings [of a regulated investment company] tend not to be regarded as their own, but as their shareholders". . . . For shareholders [of regulated investment companies], dividends are classified as ordinary, capital gain, exempt interest, or return of capital, depending on the type of earnings from which they [the dividends] are paid.

7 Stand. Fed. Tax Rep. 1991 (CCH) ¶ 26,633.01.

> A mutual fund [regulated investment company] is a pool of assets, consisting primarily of portfolio securities, and belonging to the individual investors holding shares in the fund.

Burks v. Lasker, 441 U.S. 471, 480 (1979).

Based upon the specific statutory characteristics of regulated investment companies, various state courts have determined that dividends from a regulated investment company which has invested in federal obligations are exempt from state taxation to the extent that they are attributable to interest earned on the federal obligations. As the Minnesota Supreme Court said, "the ability of a taxpayer to demonstrate with specificity a direct attribution of income to the tax-exempt federal obligations is sufficient to overcome any technical nomenclature." *Yurista*, 460 N.W.2d at 27.

Unlike a regulated investment company, the Civil Service Retirement and Disability Fund is not a "conduit" or "pass through" for investment, and the r irement annuities it pays to retirees have none of the characteristics of distributions from a regulated investment company. As discussed above in part I.B., the retirement annuities that the Fund pays to retirees are compensation for their past years of government service. The fact that the annuity payments are compensation for services and not interest is confirmed by uncontradicted experts who both concluded that the payments are for prior services and that it would be inappropriate to characterize any portion of Petitioners' retirement annuities as interest on U.S. Government obligations. S.App. 3, 4, 6. It is further confirmed by the fact that Petitioners could not have any investment balance in the Fund, having previously received more than they ever paid into the Fund. App. C-5.

Further, the ap licable statutes do not make the Fund a "conduit" or "pa through" entity. Petitioners use the

terms "pass through" and "conduit" without acknowledging that these are not statutory nor even precisely defined terms. These terms are short-hand labels used to refer to entities to which statutes have given particular tax characteristics similar to those of regulated investment companies described above. For example, partnerships are commonly described as "pass through" or "conduit" entities. Just as the relevant tax characteristics of regulated investment companies are found in 26 U.S.C. §§ 851-855 (1988), the relevant tax characteristics of partnerships are found in 26 U.S.C. (Internal Revenue Code (I.R.C.)) §§ 701-761 (1988). "S" corporations, estates, and simple trusts are also commonly called "pass through" or "conduit" entities. However, the particular statutorily defined characteristics of each of these entities is different from each other. 26 U.S.C. (I.R.C.) §§ 1361-1375 ("S" corporations), 641-692 (estates and trusts) (1988).

For tax purposes, the Fund is treated as a qualified pension plan trust (App. C-5) and so is given the specific characteristics provided by 5 U.S.C. §§ 8301 *et seq.* (1988) and 26 U.S.C. (I.R.C.) §§ 401, 402, 501 and 72 (1988). These provisions are adopted by Minnesota by Minn. Stat. §§ 290.01, subd. 19 and 290.05. subd. 2 (1986). Review of these provisions shows that the Fund lacks characteristics like those of regulated investment companies, partnerships, simple trusts and "S" corporations. While the Fund is tax exempt, the statutes do not provide that each Fund participant is treated as though he directly earned a proportionate share of the Fund's income. The Fund is not a "conduit" or "pass through."

The fact that the governing statutes do not give qualified pension plan trusts "conduit" or "pass through"

characteristics has long been recognized. In 1955, in a revenue ruling involving tax exempt interest, the Internal Revenue Service stated that a pension plan trust is not a "conduit" or "pass through" for interest that it receives:

> Although a distribution from an employees' trust meeting the requirements of section 401 of the Internal Revenue Code of 1954 is made in whole or in part from funds received by the trust as interest on tax-free securities, such distribution, when received or made available, is taxable income to the distributee in the manner and to the extent provided by section 402(a) of the Code.

Rev. Rul. 55-61, 1955 1 C.B. 40. This ruling stands as the unchallenged and accepted interpretation of the applicable statutes – a pension plan trust is *not* a "conduit" or "pass through." This is opposite the result that would obtain from a partnership, a simple trust, or a regulated investment company. It stands in direct contradiction to Petitioners' assertions.

Finally, the Fund is not a "conduit" or "pass through" in economic terms. The economist who reviewed the Fund concluded it was not a "pass through" entity, that it is not possible to determine an individual's share in the Fund, and that there is no sense in which participants may be said to be receiving interest from U.S. Government securities. S.App. 3; *see* S.App. 6, 7. Further, unlike distributions of income from regulated investment companies, payments to retirees from the Fund are not dependent upon nor do they increase or decrease depending upon the investment income of the fund. The two are entirely independent. App. C-4, C-5; S.App. 3.

From the foregoing, it is clear that the Fund is not a "conduit" or "pass-through" entity like a regulated investment company, and the retirement annuities the Fund pays to retired employees are very different from a regulated investment company's distributions to its shareholders. The Minnesota Supreme Court's decision in this case does not conflict with its own decision or the similar decisions of other state courts regarding the taxability of distributions from regulated investment companies.

Not only does the decision of the Minnesota Supreme Court not conflict with other state court decisions, the state court case most similar to this case is consistent with and supports the decision of the Minnesota Supreme Court. The Nebraska Supreme Court has rejected the very theory relied upon by Petitioners in this case. *Boersma v. Karnes*, 417 N.W.2d 341, 349 (Neb.), *appeal dismissed*, 488 U.S. 801 (1988). In *Boersma* one of the taxpayer's claims was that his social security benefits were, in part, interest on U.S. Government obligations and were therefore partially exempted from Nebraska income taxation by 31 U.S.C. § 3124(a) (1988). Similar to Petitioners in this case, the taxpayer in *Boersma* based this argument on the fact that the Old-Age and Survivors Insurance Trust Fund invests in interest bearing obligations of the United States. *Id.*, 417 N.W.2d at 349.[6]

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[6] The investment provisions for the Old-Age Fund in 42 U.S.C. § 401(d), (e) and (f) (1988) are strikingly similar to those for the Civil Service Retirement and Disability Fund in 5 U.S.C. § 8348(c), (d) and (e) (1988).

The Nebraska Supreme Court said that it did not know if plaintiffs' accurately stated how the laws of the United States operate, but held that in any event "the Nebraska income tax in this case does not operate as a tax on the interest generated by any U.S. financial security or obligation, but operates on moneys received, in the nature of retirement annuities . . . . Section 3124 does not prohibit the tax in question." *Boersma*, 417 N.W.2d at 349.

The *Boersma* decision thus rejected Petitioners' theory and is entirely consistent with the Minnesota Supreme Court's decision in this case.

II. THE MINNESOTA SUPREME COURT'S DECISION DOES NOT CONFLICT WITH THIS COURT'S DECISION IN *DAVIS V. MICHIGAN DEPARTMENT OF TREASURY*, 489 U.S. 803 (1989), BECAUSE MINNESOTA DOES NOT DISCRIMINATE AGAINST THE FEDERAL GOVERNMENT OR ITS EMPLOYEES.

In *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), this Court applied the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity and codified in 4 U.S.C. § 111 (1988). Michigan's income tax on retirement benefits received from the Fund was held invalid because Michigan discriminated against retired federal employees and in favor of retired state employees.

Petitioners assert that Minnesota taxes discriminate against Federal retirees. This assertion has no factual basis. Minnesota has never treated any portion of any

retiree's annuity as U.S. obligation interest. There is no basis to conclude that Minnesota discriminates against federal retirees.

Petitioners are merely speculating that *if* a case like *Keys v. Vermont Department of Taxes* (discussed in part I.B. of this brief) arose in Minnesota, the Minnesota courts would rule consistent with *Keys*. Speculation is not a proper ground on which to seek United States Supreme Court review.

Even if at some future time the Minnesota courts were to rule in a case like *Keys*, and even if they were to rule as the Vermont courts did, then the question would be whether the decision in that case is distinguishable from this one. Such a case would be distinguishable as shown in part I.B. of this brief.

CONCLUSION

The decision of the Minnesota Supreme Court in this case is correct under the governing legal principles. It does not deviate from or conflict with *American Bank & Trust Co. v. Dallas County*, 462 U.S. 855 (1983). Nor does it conflict with the decision of any state court applying 31 U.S.C. § 3124(a) (1988). Those state court decisions are distinguishable.

Nor does the Minnesota Court's decision conflict with *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). Minnesota's taxation of Petitioners retirement annuities is no different than its taxation of other retirement annuities.

Even if the Court were concerned that the issues presented might warrant further review, it would be prudent to allow additional courts the opportunity to analyze them. Then this Court's review, if necessary, would be fully informed by that additional scrutiny.

For the reasons presented in this brief, the Petition should be denied.

Respectfully submitted,

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CASE TYPE: DECLARATORY JUDGMENT

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN FOURTH JUDICIAL DISTRICT

Robert E. Meunier, Earl W. Miller, and Edward Garin,

Plaintiffs,

v.

Minnesota Department of Revenue, and Dorothy A, McClung, in her capacity as Minnesota Commissioner of Revenue,

Defendants.

Court File No. 91-000043

AFFIDAVIT OF PAUL A. ANTON

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

PAUL A. ANTON states the following under oath:

1. I am President of Anton Financial Economics, Inc., an economic consulting firm. My business address is 256 First Avenue North, Suite 300, Minneapolis, Minnesota 55402. I was educated at the University of Minnesota. I hold a Bachelor of Arts degree (magna cum laude) from the University with majors in mathematics and economics. I subsequently completed coursework and preliminary oral exams for the Ph.D. in economics.

I have over twenty years experience as a practicing economist. From 1970 through 1979, I was a staff economist at the Federal Reserve Bank of Minneapolis. Following that, I joined First Bank System, a bank holding company located in Minneapolis. I worked for First Bank from 1979 through 1987, eventually holding the title of Director of Economics. My duties included analysis of financial markets, interest rate forecasting, and economic forecasting. I also consulted on a regular basis with portfolio manager and trust administrators in the company's trust department.

In 1987, I formed the firm of Anton Financial Economics, Inc. and have done various forms of economic consulting for both private-sector and public-sector entities. This consulting has included expert testimony in securities cases, economic advice to investment managers, and advising company officials about the investment of pension and profit-sharing accounts.

2. I have been asked to give my opinion on issues affecting the taxability of benefits of annuity payments made by the Civil Service Retirement and Disability Fund ("CSRDF") to individuals in the state of Minnesota. In preparing these comments I have relied upon information contained in the Annual Reports of the CSRDF dated September 30, 1986 and September 30, 1987 which were provided to me by the Minnesota Attorney General's Office and on my knowledge and background experience in economics and investment matters. The following are my opinions:

3. The imposition of Minnesota income taxes on annuity payments received from the CSRDF by retirees,

disabled persons, and survivors ("participants") does not increase the cost to the United States of borrowing money nor does it diminish in any degree the market value or investment attractiveness of United States government obligations. The CSRDF is required to invest its assets in U.S. government obligations and must continue to do so without regard for taxation of participants.

4. CSRDF is a defined benefit plan, meaning that the participants are entitled to a certain defined stream of benefit payments which does not depend on the amount or sources of investment income of the CSRDF. The CSRDF may pay participants from funds which are actually being received as contributions by other participants.

5. There is no sense in which participants in the plan are owners of U.S. government securities or may be said to be receiving interest on U.S. government securities. They are receiving specified payments from CSRDF which may invest idle funds in either taxable or nontaxable U.S. government obligations.

6. The CSRDF is not designed as a "pass-through" entity or partnership in which ownership and rights of ownership of the assets are passed to the participants or partners. If the CSRDF were designed in this way participants would be at risk in that the level of the monthly benefit payments would be subject to fluctuations dictated by the investment performance of CSRDF.

7. It is not possible to determine the share of the CSRDF which is attributed to any one individual.

8. The benefit payments being made to participants in the CSRDF arise out of, and are in consideration for,

prior employment with the federal government. In both the public and private sectors of the economy, the opportunity to participate in such plans is considered an important element of a compensation package and a powerful inducement to join or remain with a given employer.

END OF AFFIDAVIT.

/s/ Paul A. Anton
PAUL A. ANTON

Subscribed and sworn to before
me on February 28, 1992.

/s/ Kimberly S. Nohe
Notary Public
[seal]

Case Type: Declaratory Judgment

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN FOURTH JUDICIAL DISTRICT

Robert E. Meunier, Earl W. Miller, Edward Garin, and Minnesota Federation of Chapters, National Association of Retired Federal Employees, an unincorporated association,
Plaintiffs,

Court File No. MC-91-00043

AFFIDAVIT OF HOWARD J. BICKER

v.

Minnesota Department of Revenue, and Dorothy A. McClung, in her capacity as Minnesota Commissioner of Revenue,

Defendants.

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

HOWARD J. BICKER states the following under oath:

1. I am the Executive Director of the Minnesota State Board of Investment, having served in this capacity since December, 1982. I first joined the State Board of Investment in 1971 and before becoming its Executive Director, served in various capacities including Senior Portfolio Manager, Assistant Executive Director, and Acting Executive Director.

The Minnesota State Board of Investment presently invests more than $17 billion of which about $15 billion are pension plan assets of the three statewide public employee pension plans and about $2 billion are state moneys in the form of various cash and trust fund accounts.

I have a bachelor's degree from Winona State University and an M.B.A. in Finance from the College of St. Thomas in St. Paul.

2. I have reviewed the annual reports for fiscal years ending 9/30/86 and 9/30/87 of the Civil Service Retirement and Disability Fund (the "Fund"). Based upon those reports, and upon my professional experience and training, I state the following professional opinions:

a. The Fund is a defined benefit plan providing retirement, disability and survivor benefits. The Fund is obligated to pay these benefits without regard to whether moneys come from investment income or contributions from various sources, current or past.

b. Such benefits are typically provided by an employer as an inducement to persons to become and remain employees.

c. Monthly payments (annuity payments) received from the Fund by a retired federal employee are in consideration of services previously renderd by the employee to the federal government.

d. It is inappropriate to characterize any portion of the monthly payments received by annuitants from the Fund as interest on United States government obligations.

e. It is impracticable to determine the amount of any individual's interest or share in the Fund.

END OF AFFIDAVIT.

/s/ Howard Bicker
HOWARD J. BICKER

Subscribed and sworn to before
me on February 27, 1992.

/s/ Harriet Balian
Notary Public
[seal]